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TAGS: EINV ECON OPIC KTTB USTR MG
SUBJECT: 2010 Mongolia Investment Climate Statement, Part 3 of 3

REF: 09 STATE 124006

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¶1. As requested ref, post provides the 2010 Mongolia Investment Climate Statement. This cable, Part 3, contains sections A.10 through A.16. See septels for sections A.1-A.9

A.10 Competition from State-Owned Enterprises (SOEs)

Mongolia passed and implemented a competition law applying to foreign, domestic, and state-owned entities active in Mongolia. As a practical matter, competition between state-owned and private businesses had been declining for the simple reason that many parastatals have been privatized. The exceptions are the state-owned power and telecom industries, a national airline (international only at present), the national rail system (half-owned by Russia), several coal mines, and a large copper mining and concentration facility (also half-owned by Russia).

Although the trend had been for the GOM to extract itself from ownership of firms and other commercial assets, both the current Minerals Law of Mongolia and the 2009 Uranium Law bring the state back into mining. (See Chapter A.1: Openness of Government to Foreign Investment for fuller discussions of both the 2009 Uranium Law and Minerals Law) Under both laws, the GOM granted itself the right to acquire equity stakes ranging from 34% to perhaps 100% of certain deposits deemed strategic for the nation. Once acquired, these assets are to be placed with one of two state-owned management companies: Erdenes MGL, for non-uranium assets; or MonAtom for uranium resources. These companies are then mandated to use the proceeds from their respective activities for the benefit of the Mongolian people.

In addition, the GOM has publically discussed using the expected proceeds from mining to underwrite SOE projects in variety of sectors, beyond its current mining portfolio. These include operations in flour milling, meat-processing, telecommunications, and pharmaceuticals. Business observers have found such plans unsettling; for rather than use the revenues to create infrastructure or to provide affordable financing, the GOM seem to

want to enter into direct competition with both foreign and domestic private investors. From statements by GOM policy representatives, investors might conclude the GOM is clearly considering giving its SOE preferential financing at rates not available to commercial firms.

The role of state as an equity owner, in terms of management of revenues and operation of the mining asset, remains unclear at this point. Currently, most GOM's assets are managed by professionals appointed by the State Property Committee (SPC), which ultimately answers to Parliament and the Prime Minister. How the SPC selects management and boards of directors remains non-transparent, but observers perceive the process to be politicized, with Parliament playing a key role in appointments.
There are some concerns over the capacity of the GOM to deal with conflicts of interest arising from its position as both regulator and owner of these strategic assets. Specifically, firms are worried that the GOM's desire to maximize local procurement, employment, and revenues may comprise the long term commercial viability of any mining project. In addition, discussions are underway to set up three new state-owned holding entities to manage assets in three priority areas -- mining, energy, and infrastructure -- then take the companies public to raise investment revenues through the capital markets.

Mongolia currently lacks a sovereign wealth fund (SWF); however, the GOM has expressed an interest in using mining revenues to create such a fund. The issue remains under review.

A.11 Corporate Social Responsibility (CSR)
It is early days for corporate social responsibility (CSR) in Mongolia. Most western companies make a good faith effort to work with the communities in which they invest. These efforts usually

take the form of specific projects aimed at providing missing infrastructure-wells, power, medical and educational structures-or such support for education as books and scholarships. The larger western firms tend to follow accepted international CSR practices and underwrite a full range of CSR activities across Mongolia; however, the smaller ones, lacking sufficient resources, limit their CSR actions to the locales in which they work. Only the largest Mongolian firms regularly undertake CSR actions, with small to medium -sized enterprises generally (but not always) limiting the use of limited resources to underwrite CSR actions.
Generally, firms that pursue CSR are perceived favorably, at least within the communities in which they act. Nationally, responses range from praise from politicians to cynical condemnation by certain civil society groups of CSR actions as nothing more than an attempt to "buy" public approval.

A.12 POLITICAL VIOLENCE

Mongolia is peaceful and stable. Political violence is rare. Mongolia has held nine (9) peaceful presidential and parliamentary elections in the past 16 years. However, a brief but violent outbreak of civil unrest followed disputed parliamentary elections on July 1, 2008. Accompanied by some property destruction and bodily injury, the unrest was quickly contained and order restored. There has been no repeat of this civil unrest since July 1. Mongolia held peaceful presidential elections in May 2009 in which the incumbent president was defeated and power smoothly transitioned to the current president

Mongolia has an ethnically homogenous population: 97percent of the population is Khalkh Mongol. The largest minority, numbering an estimated 90,000 people, is Kazakh (Muslim), concentrated in the far western part of the country.

There have been no known incidents of anti-American sentiment or politically motivated damage to American projects or installations in at least the last decade. However, Mongolia has seen a gradual and perceptible level of rising hostility to foreign nationals in general and to Chinese nationals in particular. This hostility has led to some instances of improper seizure of Chinese-invested property; and in more limited cases acts of physical violence

against the persons and property of Chinese nationals resident in Mongolia. Other Asians living in Mongolia have expressed concern that they may inadvertently become victims of this hostility.

A.13 CORRUPTION

Corruption in Mongolia, including bribery, raises the costs and risks of doing business. Corruption corrodes market opportunities in Mongolia for U.S. companies as well as the overall Mongolian business climate. It also deters international investment into Mongolia, stifles economic growth and development, distorts prices, and undermines the rule of law.

It is important for U.S. companies, irrespective of their size, to assess the business climate in Mongolia to have an effective compliance program or measures in place to detect and prevent corruption, including foreign bribery. U.S. individuals and firms operating or investing in such foreign markets as Mongolia should take the time to become familiar with the relevant anticorruption laws of both Mongolia and the United States in order to comply with them, and where appropriate, they should seek the advice of legal counsel.

The U.S. Government seeks to level the global playing field for U.S. businesses by encouraging other countries to take steps to criminalize their own companies' acts of corruption, including bribery of foreign public officials, by requiring them to uphold their obligations under relevant international conventions. A U. S. firm that believes a competitor is seeking to use bribery of a foreign public official to secure a contract should bring this to the attention of appropriate U.S. agencies, as noted below

Current Views on Mongolian Corruption

In mid-2005, the USAID Mission to Mongolia, in collaboration with USAID/Washington and The Asia Foundation (TAF), funded a corruption assessment conducted by Casals & Associates, Inc. (C&A) The complete report is available at http://www.usaid.gov/mn. Follow-up surveys of the problem show that the results of this assessment remain valid in 2010. The study found that opportunities for corruption continue to increase in Mongolia at both the "petty" or administrative and "grand" or elite levels. Both types of corruption should be of concern to Mongolians, but grand corruption should be considered a more serious one because it solidifies linkages between economic and political power that could negatively impact or ultimately derail or delay democracy and development. Several inter-related factors contribute to Mongolia's corruption problem:

--A blurring of the lines between the public and private sector brought about by systemic conflicts of interest at nearly all levels;

--A lack of transparency and access to information, stemming in part from a broad State Secrets Law that surrounds many government functions and has yielded criticism that it renders the media ineffective and hinders citizen participation in policy discussions and government oversight;

--An inadequate civil service system that gives rise to a highly politicized public administration and the existence of a "spoils system;"

--Limited political will to actually implement required reforms in accordance with the law, complicated by conflicting and overlapping laws that further inhibit effective policy implementation;

--Weak government control institutions, including the Central Bank, National Audit Office, parliamentary standing committees, Prosecutor General, Generalized State Inspection Agency, State Property Committee, and departments within the Ministry of Finance.

The aforementioned systemic shortcomings have allowed for an evolution of corruption in Mongolia that "follows the money,"

meaning that graft on the most significant scales generally occurs most often in the industries and sectors where there is the most potential for financial gain. During the early 1990s, in the early transition toward democracy and market economy, two areas that offered particular opportunities for grand scale corruption at that time were foreign donor assistance and privatization of state-owned enterprises. As Mongolia later embarked on further policy changes to institutionalize capitalistic practices, corruption reared its head in the process of privatizing public land. As the economy continues to develop, emerging areas for corruption include the banking and mining sectors. There also are several areas that provide stable and consistent opportunities for corruption, both grand and administrative in nature, such as for procurement opportunities, issuance of permits and licenses, customs, inspections, the justice sector, among high-level elected and appointed officials, and in the conduct a variety of day-to-day citizen- and business-to-government transactions, notably in education, health care, and city services.

Despite the fact that few of the conditions to prevent corruption from getting worse are in place, the situation has not reached the levels that are evident in many other countries with contexts and histories similar to that of Mongolia. Perhaps more importantly, there are a number of efforts underway to actively combat corruption, including:

--Government commitments to international anti-corruption regimes and protocols, such as the Anti-Corruption Plan of the Asian Development Bank/Organization of Economic Cooperation and

Development (ADB/OECD) and the United Nations Convention Against Corruption (UNCAC);

--Development of a National Program for Combating Corruption and formation of a National Council for coordinating the Program and a Parliamentary Anti-Corruption Working Group;

--Implementation of an anti-corruption law that has included the formation of an independent anti-corruption body;

--Short- and medium-term anti-corruption advocacy and "watchdog" programs initiated by civil society organizations, often with international donor support.

There is, in fact, time for Mongolians and the international community to nurture these efforts and take further action before corruption grows too large to rein in. In general, the main need in Mongolia is to develop effective disincentives for corrupt behavior at both the administrative and political levels. In its broadest configuration, this implies a strategy of increasing transparency and effective citizen oversight, as well as intra-governmental checks and balances. Without these major changes, administrative reforms may provide some small improvements, but they are unlikely to solve the problem. Specifically, the aforementioned USAID-sponsored report of 2005 makes several strategic recommendations, which remain relevant in 2010, including:

--Diplomatic engagement focused on keeping anti-corruption issues on the policy agenda, promoting implementation of existing laws related to anti-corruption, and highlighting the need for further measures to promote transparency and improved donor coordination;

--General programmatic recommendations to address conflict of interest, transparency/access to information, civil service reforms, and the independent anti-corruption body, with a definitive focus on engaging civil society and promoting public participation utilizing UNCAC as a framework;

--Specific programmatic recommendations to address loci of corruption, such as citizen- and business-to-government transactions, procurement, privatization, customs, land use, mining, banking, the justice sector, and the political and economic elite

In addition, the reputable international anti-corruption NGO Transparency International (TI) opened a national chapter in

Mongolia in 2004 (for more information, see: www.transparency.org). U.S. technical advisors are working with TI to train Mongolian staff to monitor corruption and to advocate on behalf of anti-corruption legislation and, TI first included Mongolia in its annual "Perceptions of Corruption" survey in September 2004. In that initial survey, Mongolia ranked 85 out of 145 countries and its score of 3 on the Corruption Perception Index was "poor." (TI's CPI Score relates to "perceptions" of the degree of corruption as seen by business people and country analysts and ranges between 10 (highly clean) and 0 (highly corrupt). TI's 2005 Survey ranked Mongolia 85 out 158; and again Mongolia earned a "poor" score of 3. In TI's 2006 survey, Mongolia had dropped to 99 out of 163 countries, receiving a score of 2.8-poor. In 2007, Mongolia was still 99 but out of 179 nations and had achieved a score of 3.0, a slight uptick but still poor. 2008 saw Mongolia drop to 102 out 180 nations, maintaining its poor score of 3. 2009 found Mongolia dropping to 124 out of 180 nations, and declining to a poorer score of 2.7, In short, Mongolia has declined.

One factor raising concerns about Mongolia's commitment to fight corruption is the series of amnesties granted to Mongolians found guilty of corruption or those under investigation for abuses. These amnesties happen about every three years, usually through presidential legislative action, with the most recent occurring in late 2009. Because they allow corrupt officials and those who enable them to avoid substantial prison time and fines for their improper acts, these amnesties are demoralizing for the IAAC and the

public, who question the value of tackling corruption with a government lacking the will to hold malefactors to account.

Current Anti-Corruption Law

In 2006, Parliament passed an Anti-Corruption Law (ACL), a significant milestone in Mongolia's efforts against corruption. The legislation had been under consideration since 1999.
The ACL created an independent investigative body, the Independent Authority Against Corruption (IAAC). The IAAC has four sections. The Prevention and Education Section works to prevent corruption and educate the public on anti-corruption legal requirements. The Investigation Section receives corruption cases and executes investigations. The third section collects, checks, and analyzes the legally required property and income statements of government officials. The fourth section, the IAAC's Secretariat, handle s administrative tasks. The IAAC formally began operations in August ¶2007. (For a review of the IAAC's activities from its inception through late 2008 and a general assessment of the public's current views of corruption in Mongolia see the series of Mongolia Corruption Benchmarking Surveys prepared for USAID Mongolia: http://www.usaid.gov/mn; and by The Asia Foundation Mongolia: http://asiafoundation.org

Anti-Corruption Resources Available to U.S. Citizens about the U.S. Foreign Corrupt Practices Act: In 1977, the United States enacted the Foreign Corrupt Practices Act (FCPA), which makes it unlawful for a U.S. person, and certain foreign issuers of securities, to make a corrupt payment to foreign public officials for the purpose of obtaining or retaining business for or with, or directing business to, any person. The FCPA also applies to foreign firms and persons who take any act in furtherance of such a corrupt payment while in the United States. For more detailed information on the FCPA, see the FCPA Lay-Person's Guide at: http://www.justice.gov/criminal

Guidance on the U.S. FCPA: The Department of Justice's (DOJ) FCPA Opinion Procedure enables U.S. firms and individuals to request a statement of the Justice Department's present enforcement intentions under the anti-bribery provisions of the FCPA regarding any proposed business conduct. The details of the opinion procedure are available on DOJ's Fraud Section Website at www.justice.gov/criminal/fraud/fcpa. Although the Department of Commerce has no enforcement role with respect to the FCPA, it supplies general guidance to U.S. exporters who have questions about the FCPA and about international developments concerning the FCPA. For further information, see the Office of the Chief Counsel for

International Counsel, U.S. Department of Commerce, Website, at http://www.ogc.doc.gov. More general information on the FCPA is available at the Websites listed below.

Other Assistance for U.S. Businesses: The U.S. Department of Commerce offers several services to aid U.S. businesses seeking to address business-related corruption issues. For example, the U.S. and Foreign Commercial Service can provide services that may assist U.S. companies in conducting their due diligence as part of the company's overarching compliance program when choosing business partners or agents overseas. The U.S. Foreign and Commercial Service can be reached directly through its offices in every major U.S. and foreign city, or through its Website at www.trade.gov/cs.

The Departments of Commerce and State provide worldwide support for qualified U.S. companies bidding on foreign government contracts through the Commerce Department's Advocacy Center and State's Office of Commercial and Business Affairs. Problems, including alleged corruption by foreign governments or competitors, encountered by U.S. companies in seeking such foreign business opportunities can be brought to the attention of appropriate U.S. government officials, including local embassy personnel and through the Department of Commerce Trade Compliance Center "Report A Trade Barrier" Website at tcc.export.gov/Report_a_Barrier/index.asp.

Exporters and investors should be aware that generally all countries prohibit the bribery of their public officials, and prohibit their officials from soliciting bribes under domestic laws. Most countries are required to criminalize such bribery and other acts of corruption by virtue of being parties to various international conventions discussed above.

Other Instruments: It is U.S. Government policy to promote good governance, including host country implementation and enforcement of anti-corruption laws and policies pursuant to their obligations under international agreements. Since enactment of the FCPA, the United States has been instrumental to the expansion of the international framework to fight corruption. Several significant components of this framework are the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Antibribery Convention), the United Nations Convention against Corruption (UN Convention), the Inter-American Convention against Corruption (OAS Convention), the Council of Europe Criminal and Civil Law Conventions, and a growing list of U.S. free trade agreements. Mongolia is party to the UN Convention Against Corruption and prohibits the bribery and solicitation of its public officials.

OECD Antibribery Convention: The OECD Antibribery Convention entered into force in February 1999. As of December 2009, 38 nations are party to it, including the United States (see http://www.oecd.org). Major exporters China, India, and Russia are not parties, although the U.S. Government strongly endorses their eventual accession to the Convention. The Convention obligates the Parties to criminalize bribery of foreign public officials in the conduct of international business. The United States meets its international obligations under the OECD Antibribery Convention through the U.S. FCPA. Mongolia is not a party to the OECD Antibribary convention.

UN Convention: The UN Anticorruption Convention entered into force on December 14, 2005, and there are 143 parties to it as of December ¶2009. The UN Convention is the first global comprehensive international anticorruption agreement. The UN Convention requires countries to establish criminal and other offences to cover a wide range of acts of corruption. The UN Convention goes beyond previous anticorruption instruments, covering a broad range of issues ranging from basic forms of corruption such as bribery and solicitation, embezzlement, trading in influence to the concealment and laundering of the proceeds of corruption. The Convention contains transnational business bribery provisions that are functionally similar to those in the OECD Antibribery Convention and contains provisions on private sector auditing and books and records requirements. Other provisions address matters such as prevention,

international cooperation, and asset recovery. Mongolia is a member of the UN Convention Against Corruption.

Local Laws: U.S. firms should familiarize themselves with local anticorruption laws, and, where appropriate, seek legal counsel. While the U.S. Department of Commerce cannot provide legal advice on local laws, the Department's U.S. and Foreign Commercial Service can provide assistance with navigating the host country's legal system and obtaining a list of local legal counsel.

Anti-Corruption Resources: Documents and Contacts

Resources for combating corruption in global markets include the following:

--Information about the U.S. Foreign Corrupt Practices Act (FCPA), including a "Lay-Person's Guide to the FCPA" is available at the U.S. Department of Justice's Website at: http://www.justice.gov/criminal/fraud/fcpa.

--Information about the OECD Antibribery Convention including links to national implementing legislation and monitoring reports is available at: http://www.oecd.org. See also new Antibribery

Recommendation and Good Practice Guidance Annex for companies: http://www.oecd.org

For general information about anticorruption initiatives, such as the OECD Convention and the FCPA, including translations of the statute into several languages, go to the Department of Commerce Office of the Chief Counsel for International Commerce at: http://www.ogc.doc.gov.

--Transparency International (TI) publishes an annual Corruption Perceptions Index (CPI). The CPI measures the perceived level of public-sector corruption in 180 countries and territories around the world. CPI is available at: http://www.transparency.org. TI also publishes an annual Global Corruption Report which provides a systematic evaluation of the state of corruption around the world. It includes an in-depth analysis of a focal theme, a series of country reports that document major corruption related events and developments from all continents and an overview of the latest research findings on anti-corruption diagnostics and tools. See http://www.transparency.org.

--The World Bank Institute publishes Worldwide Governance Indicators (WGI),which six dimensions of governance in 212 countries, including Voice and Accountability, Political Stability and Absence of Violence, Government Effectiveness, Regulatory Quality, Rule of Law and Control of Corruption. See http://info.worldbank.org. The World Bank Business Environment and Enterprise Performance Surveys may also be of interest and are available at: http://go.worldbank.org.

--The World Economic Forum publishes the Global Enabling Trade Report that assesses both border administration transparency (focused on bribe payments and corruption) and corruption and the regulatory environment: http://www.weforum.org

--For additional information on corruption see the U.S. State Department's annual Human Rights Report at http://www.state.gov.
--Global Integrity, a nonprofit organization, publishes its annual Global Integrity Report, which provides indicators for 92 countries with respect to governance and anti-corruption. The report highlights the strengths and weaknesses of national level anti-corruption systems. The report is available at: http://report.globalintegrity.org/

A.14 BILATERAL INVESTMENT AGREEMENTS

(NOTE: Table of bi-lateral investment agreements entered into by Mongolia deleted due to requirements of cable format. END NOTE.)

Taxation issues of Concern to American Investors

Taxation remains a key concern for Americans, other foreign investors, and Mongolian domestic investors and businesses. 2009 saw some changes in the Mongolian tax system, most of which, with the exception of the revocation of the value-added tax exemption for mining equipment, were greeted positively by most foreign and domestic investor in Mongolia. Observers noted that recent experience with tax-code revisions does suggest that both the GOM and Parliament are amenable to revising legislation if the economic benefits to the state, the public, and investors can be proven.

Windfall Profits Tax on Copper and Gold Sunsets in 2011

Since passage in 2006, the Windfall Profits Tax Law has generated criticism regarding the depth of the GOM's commitment to creating an open, predictable, and fair environment for foreign direct investment. The speedy legislative process for passing the WPT was unprecedented. This bill was passed in six days without any consultation with outside stakeholders on any its provisions. The entire process raised concerns among investors about the stability and transparency of Mongolia's legislative and regulatory environment, which intervening years and experience with other

non-transparently passed legislation did little to alleviate.

The WPT imposes a 68percent tax on the profits from gold and copper mining respectively, and for gold originally kicked in when gold the price for gold hit USD500 per ounce; however, in late 2008 Parliament raised the threshold to USD850. For copper, the threshold is USD 2,600 per ton. Mining industry sources claim that the 68percent tax rate, when combined with other Mongolian taxes, makes the effective tax 100percent on all proceeds above the copper threshold price.

The recent Oyu Tolgoi Investment Agreement entailed further amendment to the WPT as a condition precedent to its passage. OT's private investors successfully argued that they would not be able to run a commercially viable OT operation when faced with the WPT. Consequently, the Parliament agreed to amend the WPT Law: The WPT will officially end for all copper concentrate and gold products in ¶2011.

Revisions of the Mongolian Tax Code

Effective since January 1, 2007 the current tax code reduces tax rates, flattens the tax schedule, removes discriminatory loopholes and exemptions, and introduces appropriate deduction opportunities for corporate investment. The current law allows firms to deduct more types of legitimate business expenditures: training, business travel, cafeteria expenses, etc. The current law levels the playing field between foreign and domestic investors, eliminating the majority of discriminatory tax exemptions and holidays, most of which favored international investors.

2009 changes into the tax code's treatment of exemptions present something of a mixed bag for investors. On the down side, Mongolia's Parliament revoked an exemption available on value-added tax (VAT) taxes of 10percent on equipment used to bring a given mine into production. Most jurisdictions, recognizing that most mines have long development lead times before production begins, either waive or do not tax such imports at all. Parliament, with no consultation with investors, international advisors provided by donor organizations, or even of its own tax officials, chose to impose the VAT, which immediately makes Mongolian mining costs 10percent higher than they would otherwise be, impairing competitiveness and dramatically varying from global practice.

On the plus side, Parliament revised loss-carry forward provisions, extending from two (2) years to eight (8) years the ability to deduct losses from taxes after incurring a loss. Like the revision of the WPT, this change is also a condition precedent of passing the OT Agreement. Most investors find eight years sufficient for many Mongolian investments that require impose long, expensive development horizons before producing any sort of profit.

Unfinished Taxation Business: Improving Institutions and Practices

As reported in the 2009 Investment Climate Statement and Country Commercial Guide, both the GOM and Parliament has been intending to take up additional tax reform measures since 2007 but have made no substantive progress since promising additional reforms. These measures include revisions to the law on customs and customs tariffs. While the exact nature of the proposed changes to the customs law remains murky, the GOM states that changes will be consistent with Mongolia's WTO obligations and best practices.

Despite overall solid, positive changes, international financial institutions warn that tax reforms by themselves are insufficient to improve Mongolia's business environment. They report that reform must go beyond changes to the tax code to restructure the operations of the key agencies - the tax department, the customs administration and the inspections agency - that directly interact with private firms and individuals.

Specifically, tax authorities charged with enforcing the tax codes

require a more customer-based approach to dealing with their business clientele and a more detailed and rigorously enforced regulatory framework under which to audit company accounts. Many foreign and domestic investors argue that the lack of such a clear, implementable code of ethics and enforceable set of guidelines leads to arbitrary, capricious, or predatory tax audits.

A.15 OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

The U.S. government's Overseas Private Investment Corporation (OPIC: (www.opic.gov) offers loans and political risk insurance to American investors involved in most sectors of the Mongolian economy.

The U.S. Export-Import Bank (EXIM: www.exim.gov)offers programs in Mongolia for short-, medium-, and long-term transactions in the public sector and for short- and medium-term transactions in the private sector.

Mongolia is a member of the Multilateral Investment Guarantee Agency (MIGA: www.miga.org).

¶A. 16 LABOR

Mongolia's labor pool is generally well educated, relatively young, and adaptable, but shortages exist in most professional categories requiring advanced degrees or training. Only time and investment in education and training will remedy this deficit of trained skilled labor. Unskilled labor is sufficiently available. Shortages exist in both vocational and professional categories because Mongolians who obtain such skills frequently go abroad to find higher wages. Foreign-invested companies are dealing with this situation by providing in-country training to their staffs, raising salaries to retain employees, or hiring expatriate workers to provide skills and expertise unavailable in the local market. In addition, the USG funded Millennium Challenge Corporation (MCC) is underwriting a five-year training and vocational education program (TVET) to develop sustainable programs to help Mongolia meet its needs for skilled blue- collar workers (http://www.mca.mn or http://www.mcc.gov).

Mongolian labor law is not particularly restrictive. Investors can locate and hire workers without using hiring agencies -- as long as hiring practices are consistent with Mongolian Labor Law. However, Mongolian law requires companies to employ Mongolian workers in certain labor categories whenever a Mongolian can perform the task as well as a foreigner. This law generally applies to unskilled labor categories and not areas where a high degree of technical expertise nonexistent in Mongolia is required. The law does provide an escape hatch for all employers. Should an employer seek to hire a non-Mongolian laborer and cannot obtain a waiver from the Ministry of Labor for that employee, the employer can pay a fee of USD 140.00 per employee per month. Depending on a project's importance, the Ministry of Labor can exempt employers from 50percent of the waiver fees per worker.

Foreign and domestic investors consistently argue that they bear too much of the social security costs for each domestic and foreign hire under the amended 2008 Social Insurance Law enacted in July 2008. Foreign employees became liable for social insurance taxes if they reside within Mongolia for 181 days within a 365 day period. Under this law, foreign and domestic workers pay up to 108,000 tugrik per month (USD 74) for this tax, no matter their respective rates of pay. Employers must pay a tax equivalent to 13percent of the annual wage on both domestic and foreign workers. Given that state pensions have yet to broach even USD 100, employers argue that pensions are not commensurate with worker contributions, especially those of highly-paid ex-patriot employees. In addition, workers must pay in for twenty years in order to be vested, highly unlikely for many ex-patriot employees, who reside in Mongolia for less than three years on average. Local and foreign business associations are attempting to work with both the government and Parliament to address these perceived inequalities.

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ILO conventions

Mongolia has ratified 15 ILO conventions (http://www.ilo.org) (NOTE: Table of ILO conventions ratified by Mongolia deleted due to requirements of cable format. END NOTE.)

¶A. 17 FOREIGN TRADE ZONES/FREE PORTS

The Mongolian government launched its free trade zone (FTZ) program in 2004. Currently there are two FTZ areas located along the Mongolia spur of the trans-Siberian highway: one in the north at the Russia-Mongolia border town of Altanbulag and the other in the south at the Chinese-Mongolia border at the town of Zamyn-Uud. Both FTZs are inactive, with no development at either site. The port of entry of Tsagaan Nuur in Bayan-Olgii province is being considered as the site of a third FTZ.

Management for the Zamyn-Uud Free Trade Zone (ZUFTZ) was originally tendered to a Chinese firm. In 2006, the GOM voided the agreement for non-compliance with the terms of the tender. The GOM re-tendered the management contract in 2006, but later voided that contract, alleging that the current holder of the management rights in the ZUFTZ had failed to live up to the terms of the tender.

So far, there are no indications that government will not keep promises to open the zone to any who satisfy the relevant legal requirements. However, there are concerns about the Mongolian free trade zones in general and Zamyn-Uud in particular. In April 2004, the USAID sponsored Economic Policy Reform and Competitiveness Project (EPRC: http://www.eprc-chemonics.biz/) made the following observations of Mongolia's FTZ Program. In 2010, these issues remain concerns:

--Benchmarking of Mongolia's FTZ Program against current successful international practices shows deficiencies in the legal and regulatory framework as well as in the process being followed to establish FTZs in the country.

--Lack of implementing regulations and procedural definitions encapsulated in transparency and predictability quotient required to implement key international best practices.

--A process of due diligence, including a cost-benefit analysis, has not been completed for the proposed Zamyn-Uud FTZ.

--Identifiable funding is not in place to meet off-site infrastructure requirements for Zamyn-Uud and Altanbulag sites.

--Deviations from international best practices in the process of launching FTZs risks repeating mistakes made in other countries and may lead to "hidden costs" or the provision of subsidies that the government of Mongolia did not foresee or which will have to granted at the expense of other high priority needs.

¶A. 18 FOREIGN DIRECT INVESTMENT STATISTICS:

The Foreign Investment and Foreign Trade Agency (FIFTA) provides most of the data for tracking FDI in Mongolia. However, the data has limitations:

Incomplete reporting

Many foreign firms provide FIFTA with inaccurate or incomplete data on their annual investment amounts. FIFTA's registration regime requires companies to document business plans and total FDI for the coming year. FIFTA uses these amounts to determine FDI for the year. However, firms reportedly believe FIFTA may not be able to guarantee the confidentiality of proprietary business information, and so they withhold complete data on their actual activities.

Mongolia suffers from promised investment that never materializes or

which comes in at a lower level than originally stated. FIFTA does not update reports to account for these or other changes to investments during the year. (See Chapter 6, Section A.5: Performance Requirements and Incentives).

Many of Mongolia's largest foreign- owned or foreign-invested entities are in the mining sector, which because of a quirk of the current Minerals Law of Mongolia are not necessarily defined as foreign-invested firms. The current minerals law specifies that only domestically registered mining firms can have mining licenses registered in their names, which means that foreign investments associated with mining may not be recorded by FIFTA, even though the investment is demonstrably foreign. For example, the investment by Ivanhoe Mines Mongolia (a Canadian company) into Mongolia has reached nearly USD 1 billion, yet this investment is not recorded among the data provided by FIFTA.

Data not Available

Neither FIFTA nor any other Mongolian agency to our knowledge tracks Mongolia's direct investment abroad.

(NOTE: Mongolian FDI statistics deleted due to requirements of cable format. END NOTE.)

ADDLETON